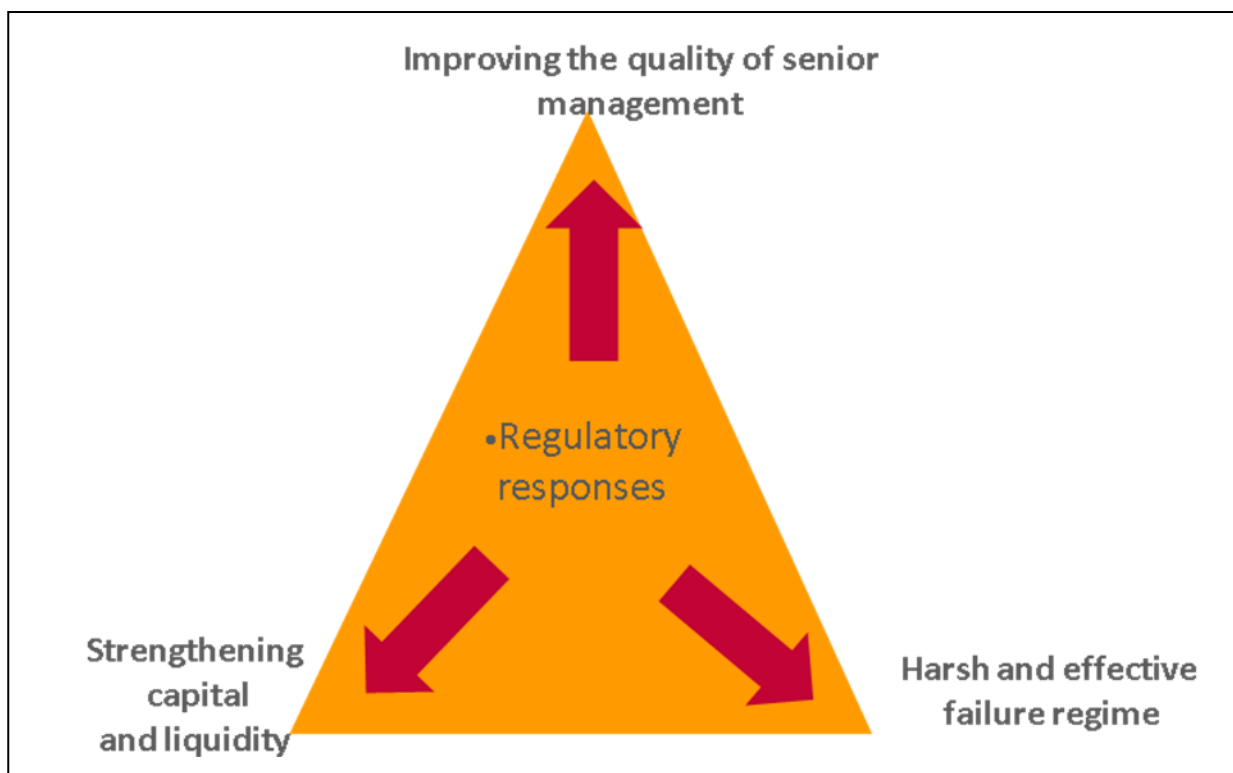


# Supporting SIFs to meet the ever increasing regulatory standards

Article

Following the economic crisis the FSA have pushed forward with developments on three fronts designed to prevent any repeat of a failure on the scale we have seen. Everything said in policy documents, plans and speeches feature the increased standards of skills, knowledge, expertise and behaviour expected of Senior Managers in Significant Influences Functions, now known as SIFs, and this article summarises these and looks at practical ways in which they can be supported to meet those standards.

All of the Consultation Papers and Policy documents have addressed three critical areas. For firms the need to carrying sufficient capital of the right quality to meet new standards such as Solvency II and Basle II. This drove the focus on Threshold Condition 4 calculations for intermediaries.



The failure of the boards of retail and investment banks to recognise the risks they were taking called into question the competence of senior management and the clarity of governance structures that permitted such risks to be taken. Several initiatives have been taken to codify the existing standards for SIFs.

2009 and into 2010 has seen an unprecedented number of enforcement actions against individual including some which are based on breaches of the Principles and Code of Practice for Approved Persons rather than straightforward dishonesty which has tended to be the case in the past.

SIFs need all the help they can get to make sure that they can evidence that they have:-

1. Allocated responsibilities correctly and that the individuals a approved for the right controlled functions
2. The processes in place for the recruitment/appointment of SIFs

3. Competent people running the business
4. Crystal clear governance structures and supporting documentation
5. The right board structures for the business
6. Remuneration structures that reward the right behaviours and do not create stress between stakeholders and individuals interests

Perhaps the first task is gap analysis on these topics to establish a current state assessment of how your firms systems and controls in this area reflect the new regime. From our work with firms common areas of difficulty are:-

- Correct application of the revised control functions particularly in groups
- Lack of awareness and process for providing complete information on references for ex SIFs to the recruiting firm
- Lack of formal and rigorous competence assessment and records
- Out of date, incomplete or absent Terms of reference for the Board and its Committees
- Out of date or absent job descriptions for SIF roles
- Lack of clarity on who is responsible for ensuring the maintenance of governance documents
- Lack of a clear role for Non-executive directors
- Remuneration arrangements that do not reflect the standards (CP 10/19, PS11/10 and rules effective from 1 January 2011 extending the code to 2,500 firms)

The majority of these changes are pulled together from previous CP's and Discussion Papers and contained in CP10/3 'Effective corporate governance (Significant influence controlled functions and the Walker review). It contains the draft rules and the Policy Statement is due out in the third quarter. I always find that when draft rules are included in a CP little will change and it is hard to argue with the proposals although I am sure people will!

I would add that the "good governance requirements have always been in SYSC 1.1 which requires:

- robust governance arrangements,
- clear organisational structure
- well defined, transparent and consistent lines of responsibility,
- effective processes to identify, manage, monitor and report the risks it is or might be exposed to,
- internal control mechanisms, including sound administrative and accounting procedures and effective control and safeguard arrangements for information processing systems.

These developments expand on what the FSA's expectations are in these areas.

The clearest way to review your arrangements is to address two distinct areas the governance of the firm and the suitability of the people.

#### 1. The firms Governance Structure

Ahead of an Arrow visit the FSA is tending to ask for the following documents in connection with Governance and the length of the list alone shows the importance the FSA are attaching to this topic:-

- Board and sub committee structure charts showing their reporting lines (including any reporting lines from other group entities)

- Details of matters reserves for the boards or for other entities in the group
- Details of membership of: the Board, and Sub committees
- Terms of reference for the:
  - Board
  - Sub Committees and
  - Key executive committees
  - Senior management structure chart including chart showing membership of any key executive committees
  - Terms of reference/job descriptions (including a rough split of the proportion of their time spent on each entity/job:
    - Executive Directors
    - Senior management
    - NEDs (including a note on their independence, tenure, list of other boards they sit on)
- Board pack for last 2- 4 meetings
- Packs for last meetings of key sub committees
- Signed minutes of:
  - All Board meetings (including group) in last 12 months
  - All meetings of key committees in last 12 months
  - The last meeting of any other sub committees
  - All meetings of key executive committees in last 6 months

Pulling together this information and reviewing it for completeness is a valuable review. Look particularly for a clear picture of boards and committees powers, the appropriateness of the members of the Audit Committee (are they all independent?) the challenges that have been raised by the Non-executives at meetings and evidence of how matters outstanding are carried forward and picked up. A useful discipline for the latter is a running list of matters outstanding with details of who is responsible for reporting back to the board and when.

Also apply the new Control Functions to your structure and consider carefully the definition of “significant influence” where you are part of a group with parent and holding companies who exercise influence over your board.

## 2. Individual fitness and propriety

The clearest statement concerning what areas should be considered when assessing the competence of a person to carry out a Significant Influence Function (SIF) come from Hector Sants speech on the 7<sup>th</sup> May 2009.

*“Assessment of SIF competence in post will be based around evidence to support the following areas:*

**Knowledge:** *Does the individual have and use the generic knowledge of the sector and the specific knowledge of the firm necessary to fulfil the role?*

**Skills:** *Does the individual demonstrate the business and interpersonal skills required to fulfil the role and to meet the required standards?*

**Behaviour:** *Does the individual demonstrate the attitudes and standards of ethical behaviour required to fulfil their role?*

**Expertise:** *Does the individual achieve positive and fair outcomes and meet the performance standards expected for the post?”*

All very laudable, but the challenge for those involved in compliance, HR, Learning and Development within firms is HOW to put in place the systems and controls to evidence that SIFs are competent particularly when raising the topic is often taken as an implied criticism rather than a solution

Key documents to look for include:

- Certified originals of certificates of qualifications
- Record of past training and CPD (something SIFs may wish to keep themselves in future)
- Copies of all documents in the recruitment process
- Notes of investigations into gaps in employment
- References taken up
- Results of searches (financial and police)
- Copies of formal assessments
- Employment history in the firm

This is also a useful checklist for the recruitment of new SIF's whether externally or internally as the FSA are reviewing applications for authorisation carefully and expecting firms to have this information in place with CRB and financial checks.

The following is a list of the most common areas to improve:-

- Job descriptions that are either very sketchy or endlessly long, detailed lists of tasks
- Confusion between different parts of the business as to what competence means
- Boredom and unwillingness to participate in what is seen as time consuming irrelevance
- View that Training & Competence or Performance Management is for workers not leaders
- Embarrassment at board level about carrying out appraisals on co-directors
- Assumptions that providing financial results are achieved nothing else really matters
- Unwillingness to address problems with behaviours in case a big contributor of profit leaves
- Lack of competence to set objectives, assess and coach at senior levels.

The areas the FSA has said it will look for and assess SIFs competence are:-

- Market knowledge
- Business strategy and model
- Risk Management and control
- Financial analysis and controls
- Governance, oversight and controls
- Regulatory framework and requirements

(CP10.03 4.25)

The competence of the Board and how it is evaluated and evidenced normally falls to the Chairman to organise and alerting him/her to the FSA's new standards and how best to address them should be where you start. Do consider external help to engage your SIFs in this topic which can remove some of the internal sensitivities that will exist and enable a more rigorous debate than an internal facilitator can provide.

Finally look carefully at the information you hold about your SIFs and bear in mind that you will need to provide relevant factual information to a new employee and whether the person left under a compromise agreement.

There are benefits from this work and often long standing peculiar structures can be addressed. Board reviews can add value to the way the board operates and filling gaps in competence leads to improved debate of business issues. The role of compliance is key to selling the benefits of changes of this sort to the board but I know from experience this is not easy so good luck!

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